



MULTISTATE TAX COMMISSION

Working Together Since 1967 to Preserve Federalism and Tax Fairness

To: Robynn Wilson, Chair
Members of MTC Income & Franchise Tax Uniformity Subcommittee
From: Shirley Sicilian, General Counsel
Date: February 18, 2011
Subject: **Model Use Tax Notice and Reporting Project**

I. The Draft Model Statute

At its December 7, 2010 meeting, the Subcommittee directed the drafting group¹ to make several changes to the model use tax reporting statute. Those changes were made, and adopted by the Subcommittee at its teleconference of February 8, 2011. During the teleconference, the Subcommittee also directed one additional change: to delete “90” as the number of days a seller has to protest an assessment of penalty before the penalty becomes final, and instead indicate that the statute should match the protest period for tax assessments and refund denials. All changes are reflected in the draft (attached at p. 4). Key features are:

- **Stand-Alone Act:** The model is designed as a stand-alone Act, rather than as part of the tax statute, because it does not impose a tax or require collection of a tax.
- **Requires Notices and Reports.** Sellers that do not collect and remit state sales or use taxes on items delivered into the state must provide: (1) notice to customers at the time of the transaction, as a public service to assist customers in understanding that tax is not being collected and that the customer may owe the tax directly to the department, (2) Annual report to customers, as a public service to assist customers in remitting tax directly to the department, and (3) Annual report to the tax department, to assist it in identifying non-filers.
- **Exceptions:** There are exceptions to these requirements for: (1) small sellers, (2) sellers with only de minimis in-state sales, and (3) sellers that are registered to collect the tax.
- **Penalties and Interest:** Penalties apply for failure to provide notice or reports, and interest accrues on the penalty once it becomes final.
- **Confidentiality:** All customer information received by the tax agency shall be treated as confidential taxpayer information.

II. Recent Developments

A. Judicial Developments

Colorado enacted a use tax notice and reporting statute during its 2010 session, and soon afterward the Direct Marketing Association filed suit in the U.S. District Court for the

¹ Richard Cram (KS), Phil Horwitz (CO), Michael Fatale (MA), and staff, Roxanne Bland and Shirley Sicilian.

District of Colorado arguing that the new law violates several state and federal constitutional provisions, including the dormant commerce clause, right to privacy, and right to free speech. On January 26, 2011, the Court granted the DMA's motion to enjoin Colorado from administering its use tax notice and reporting statute while the lawsuit is pending. DMA based its motion for preliminary injunction solely on its Commerce Clause argument. The Court agreed to issue the preliminary injunction because it found DMA is likely to succeed on its Commerce Clause Argument, Colorado's enforcement during the pendency of the lawsuit would cause irreparable injury to DMA's members, the harm to DMA from Colorado's enforcement outweighs the harm to the Colorado from injunction, and the public interest is best served by injunction. Here is a link to the decision:

<http://www.the-dma.org/segment/segmentfiles/catalogers/20110126OrderGrantingPI.pdf>

The Court held:

1. DMA has a likelihood of success on its Commerce Clause argument, because

- i) **The Act likely discriminates.** Colorado argued the Act did not discriminate between in-state and out-of-state sellers because it applied to all sellers, in-state and out-of-state, equally – with an exception for any seller, in-state or out-of-state, that collects and remits tax. The Court reasoned: (1) retailers who collect/remit are not obligated to provide notice/reports, (2) in-state retailers are obligated to collect/remit, while out-of-state retailers are not obligated to collect/remit, thus (3) Only out-of-state retailers will be obligated to provide notice/reports, and so (4) although the Act does not explicitly target out-of-state sellers, there is a substantial likelihood it will be held discriminatory because “in practical effect, [it] impose[s] a burden on interstate commerce that is not imposed on in-state commerce.”
- ii) **The Act likely burdens.** If an Act is discriminatory, it violates the Commerce Clause unless it serves a legitimate local purpose which cannot be achieved through reasonable, nondiscriminatory alternatives (*Pike* test). The Court used the first and fourth prongs of *Complete Auto* (nexus and fair relation to benefits provided) to evaluate burden. The Court is obviously evaluating this case using tax law standards and not as a public notice or public information type requirement. Indeed, the Court then reasoned that: (1) the “sole purpose of the burdens imposed is the ultimate collection of use taxes,” thus (2) the burdens imposed are inextricably related ...to the burdens condemned in Quill,” and (3) out-of-state sellers likely “are protected from such burdens ...by the safe-harbor established in Quill.”

2. Enforcement would cause irreparable injury. A recent 10th Circuit case (*American Civil Liberties Union v. Johnson*, citing *American Libraries Ass’n v. Pataki*) flatly states that a violation of Commerce Clause rights constitutes irreparable injury. Court recognized the statement as dicta, but went with it. The Court also noted the State’s 11th amendment immunity would prohibit sellers from recovering compliance expenses if the Act is struck down.

3. Harm to DMA outweighs harm to State. The Court found that delaying notice and reports might delay State use tax collection, but will not prevent it. On the

other hand, it found that preserving the status quo will prevent irreparable injury from commerce clause infringement and unrecoverable compliance costs.

- 4. Public Interest would be served by injunction.** The Court found that the public interest is served by enjoining a likely violation of the commerce clause, and will not be substantially impaired by potential delay in revenue collections that, at any rate, would only be induced by a likely unconstitutional Act.

B. Legislative Developments

Last year, two states enacted legislation imposing notice and/or reporting requirements on sellers that do not collect sales or use tax. This year, similar legislation has been introduced in three states.

Enacted, 2010 session

- **Colorado** – §39-21-112(3.5), C.R.S. (2010) (notice and annual reports to purchaser and Department) link to Colorado statutes:
<http://www.michie.com/colorado/lpext.dll?f=templates&fn=main-h.htm&cp=1>
1 Colo. Code Regs. § 201-1:39-21-112.3.5 (2010)
<http://www.colorado.gov/cs/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1251641794838&ssbinary=true>
- **Oklahoma** – Okla. Stat. §710:65-21-8
<http://www.tax.ok.gov/rules/710-65-21-8%20ADOPTED.pdf>

Introduced, 2011 session:

- **California** – AB 155 (notice and annual reports to purchaser and BOE)
http://www.leginfo.ca.gov/pub/11-12/bill/asm/ab_0151-0200/ab_155_bill_20110118_introduced.html
- **South Dakota** – SB 146 (requires notice)
<http://legis.state.sd.us/sessions/2011/Bill.aspx?File=SB146P.htm>
- **Hawaii** – HB 1183 - (presumes entities with “click-through” affiliates have nexus, requires them to file annual report with the Department)
http://www.capitol.hawaii.gov/session2011/bills/HB1183_.HTM



MULTISTATE TAX COMMISSION

Working together since 1967 to preserve federalism and tax fairness

Sales & Use Tax Uniformity Subcommittee

Draft Model Sales & Use Tax Notice and Reporting Act

February 18, 2011

Draft – For Discussion Purposes Only

Sales and Use Tax Notice and Reporting Act

- (a) **Administration.** The [State Department of Revenue] shall perform all functions necessary and proper for the administration and enforcement of this Act, including promulgating regulations and reviewing protests in accordance with the [State Administrative Procedures Act].
- (b) **Definitions.** For purposes of this Act:
- (1) **“Department”** means the [State Department of Revenue].
 - (2) **“Director”** means the Director of the [State Department of Revenue].
 - (3) **“Purchaser”** means any person who purchases or leases a product for delivery to a location in this state.
- (c) **Notice and Reports, Required.** A person who sells or leases a product; the storage, use, or consumption of which is subject to [State Use Tax Act], or the sale or lease of which is subject to [State Sales Tax Act]; but who does not collect and remit either such tax, shall provide the following notice and reports.
- (1) **Notice to Purchaser at Time of Transaction.** A notice shall be provided to each purchaser at the time of each such sale or lease.
 - (A) The notice shall indicate that neither sales nor use tax is being collected or remitted upon the transaction, and that the purchaser may be required to remit such tax directly to the Department.
 - (B) The notice shall be prominently displayed on all invoices and order forms, including, where applicable, electronic and catalogue invoices and order forms, and upon each sale or lease receipt provided to the purchaser. No indication shall be made that sales or use tax is not imposed upon the transaction, unless: (i) such indication is followed immediately with the notice required by this section (c)(1); or (ii) the

transaction with respect to which the indication is given is exempt from [State] sales and use tax pursuant to [State] law.

(2) **Annual Report to Purchaser.** A report shall be provided to each purchaser before January 31st of each year.

- (A) The report shall include:
 - (i) a statement indicating that the person did not collect sales or use tax on the purchaser's transactions and that the purchaser may be required to remit such tax directly to the Department;
 - (ii) a list, by date, generally indicating the type of product purchased or leased during the prior calendar year by the purchaser from such person for delivery to a location in this state and the price of each product;
 - (iii) instruction for obtaining additional information regarding whether and how to remit the sales or use tax to the Department;
 - (iv) a statement that such person is required to submit a report to the Department pursuant to section (c)(3) of this Act stating the total dollar amount of the purchaser's purchases; and
 - (v) any information as the Director shall reasonably require.
- (B) The report shall be sent to the purchaser's billing address, or if unknown, the purchaser's shipping address, in an envelope marked prominently with words indicating important tax information is enclosed. If no billing or shipping address is known, the report shall be sent electronically to the purchaser's last-known e-mail address with a subject heading indicating important tax information is enclosed.

(3) **Annual Report to [State Department of Revenue].** A report shall be provided before January 31st of each year to the Department.

- (A) The report shall include, with respect to each purchaser:
 - (i) the name of the purchaser;
 - (ii) the billing address and, if different, the last known mailing address;
 - (iii) the shipping address for each product sold or leased to such purchaser for delivery to a location in this state; and
 - (iv) the total dollar amount of all such purchases by such purchaser which were made during the prior calendar year for delivery to each such address.
- (B) The report shall be filed electronically in the form and manner required by the Director.

(d) **Exceptions.**

- (1) **Small Seller.** A person who made less than \$A [original SST threshold for small seller was \$100,000] in total gross sales during the prior calendar year

shall not be required to provide notice or file reports pursuant to section (c) of this Act.

(2) **De minimis In-State Sales.** A person who made less than \$B [CO: \$100,000] in total gross sales for delivery to a location in this state during the prior calendar year shall not be required to provide notice or file reports pursuant to section (c) of this Act.

[(3) **Sales by Registered Sellers.** A person who is registered to collect and remit sales and use tax, and who complies in good faith with the [State Sales and Use Tax Acts], shall not be required to provide notice or file reports pursuant to section (c) of this Act.

(e) **Penalties.**

(1) **Amount.** The Director shall assess a penalty upon any person who fails to provide notices and reports as required by this Act as follows:

(A) **Penalty for Failure to Provide Notice to Purchaser at Time of Transaction.** A person who fails to provide notice as required by section (c)(1) shall be assessed a penalty, in addition to any other applicable penalties, in the amount of \$X for each such failure, not to exceed:

- (i) a total of \$Y in one calendar year, if such person remedied each failure by providing such notices within X days of the date such notice was required to be provided, and
- (ii) a total of \$Z in one calendar year where section (e)(1)(A)(i) of this Act does not apply

(B) **Penalty for Failure to Provide Annual Report to Purchaser.** A person who fails to provide a report as required by section (c)(2) shall be assessed a penalty, in addition to any other applicable penalty, of \$X for each such failure, not to exceed:

- (i) a total of \$Y in one calendar year if such person remedied each failure by providing such notices within X days of the date such report was required to be provided, and
- (ii) a total of \$Z in one calendar year where section (e)(1)(B)(i) of this Act does not apply.

(C) **Penalty for Failure to Provide Annual Report to Department.** A person who fails to provide a report as required by section (c)(3) shall be assessed a penalty, in addition to any other applicable penalty, equal to \$X times the number of such purchasers that should have been included on such report, not to exceed:

- (i) a total of \$Y in one calendar year if such person remedied the failure by providing the report within X days of the date such report was required to be provided, and
- (ii) a total of \$Z in one calendar year where section (e)(1)(C)(i) of this Act does not apply.

- (2) **Estimates Authorized.** When assessing a penalty pursuant to section (e) of this Act, the Director may use any reasonable sampling or estimation technique where necessary or appropriate to determine the number of failures in any calendar year.
- (3) **Protest.** A person may protest the assessment of any such penalty or interest by filing a written objection with the Director within [number of days equal to the number of days allowed for protest of a use tax assessment or refund denial] days of the date of assessment. Disposition of a timely filed protest shall be in accordance with [State Administrative Procedures Act]. If no such protest is filed within the time allowed, the assessment shall become final and subject to [judgment, warrant, collection procedures].
- (4) **Interest.** Interest shall accrue on the amount of the total penalty that has been assessed and become final for each calendar year pursuant to section (e) of this Act at the rate established pursuant to [state code section setting interest rate for tax underpayment].
- (5) **Waiver.** Upon written request received within the time established for protest pursuant to section (e)(4) above, the Director, in his or her sole discretion, may waive any portion or all of the penalty or interest applicable under this section for good cause shown.
- (f) **Confidentiality of Purchaser Information.** Information received by the [State Department of Revenue] pursuant to this Act shall be exempt from any disclosure required pursuant to [State Open Records Act]. Such information shall be treated as confidential taxpayer information pursuant to [cite to open records exception for confidential taxpayer information, including exceptions statutes] and all exceptions, penalties, punishments, and remedies applicable to disclosure of confidential taxpayer information pursuant to [cite to statutes regarding confidential taxpayer information disclosure exceptions and penalties] shall apply to disclosure of information received by the Department pursuant to this Act.
- (g) **Limitations.** Nothing in this Act shall relieve a person who is subject to [the state's sales tax act or the use tax act] from any responsibilities imposed thereunder. Nor shall anything in this Act prevent the Director from administering and enforcing [the state's sales tax act or the use tax act] with respect any person who is subject thereto.
- (h) **Severance.** The provisions of this Act are severable and if any section, sentence, clause or phrase of this Act shall for any reason be held to be invalid of unconstitutional, such holding shall not affect the validity of the remaining sections, sentences, clauses, and phrases of this Act, which shall remain in effect.